RIAA Ex. O-105-DP

NPD Music
Year In Review

April 4, 2005

Prepared For:

NARM

Market Summary

- 2004 - A Market Summary
- It's really a digital world
- Meet your entertainment consumer

Market Summary: Quick bits

- Music revenue was down 2% in 2004, largely due to significant price cuts. *Note: includes singles; only physical music.*

- Channel shift continued, with CD Stores losing 7.5 percentage points (ppts) in unit share from 2002 to 2004 - despite dropping prices more than any channel other than Online. Also in 2004, Discount/Mass Merchants' share was 29%, Electronics Stores captured 22% of units sold, Online had a 12% share, and Book Stores held steady at 7%.

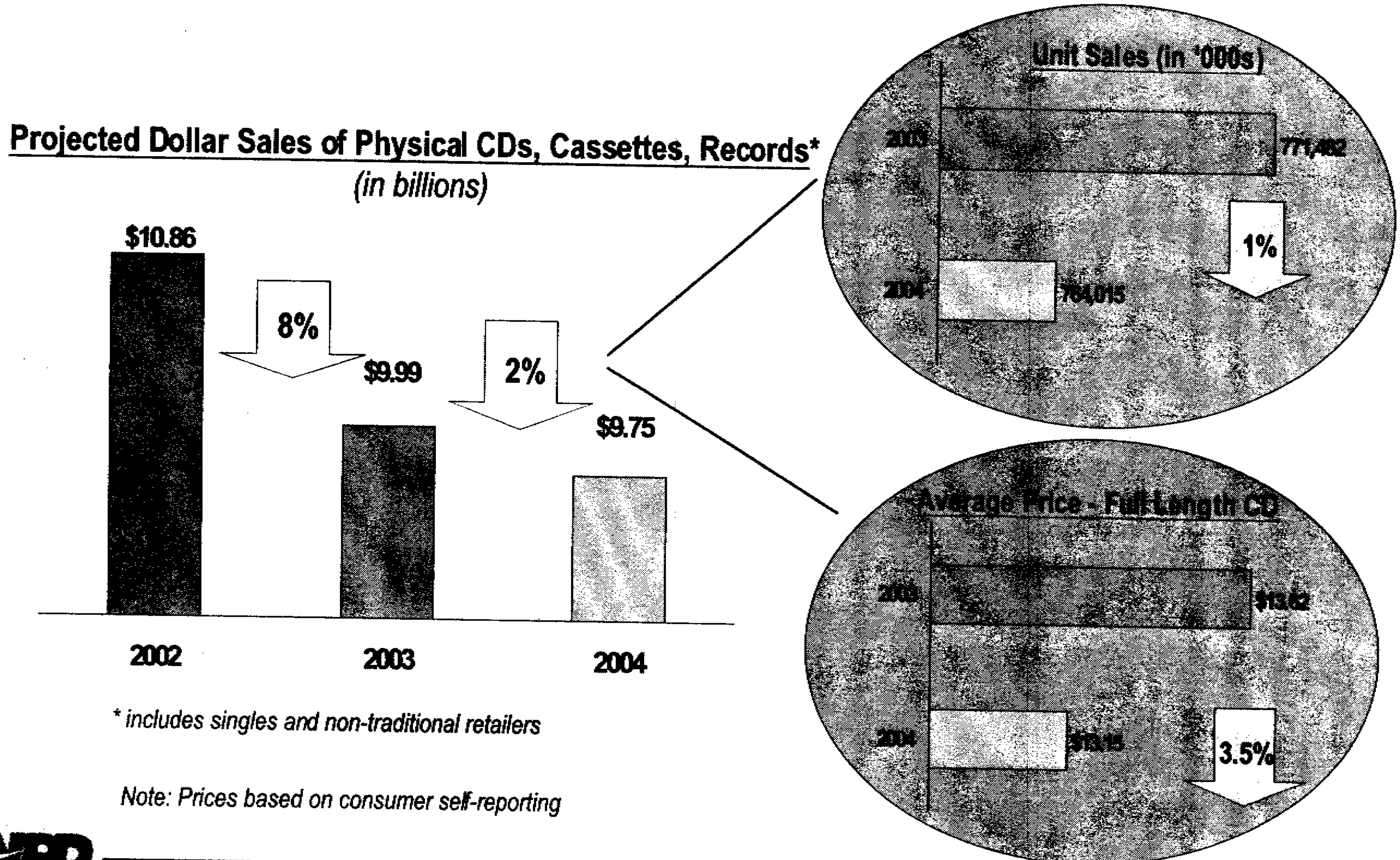
- Price isn't everything: Premium content consumers are not as price sensitive. Consumers will also respond to intangibles like customer service and listening stations - if the right intangibles are presented to the right demographics.

- Teens rebounded in 2004 - thanks in part to a wide selection of lesser-known CDs. Sales of platinum artists among teens declined.

- Relative to rock buyers, it's easier to capture a significant portion of urban music buyers with the top-selling CDs.

Market Summary: Revenue decline

Revenue for all physical music sales is down 2% from 2003 - mostly due to a 3.5% drop in the price of full-length CDs.

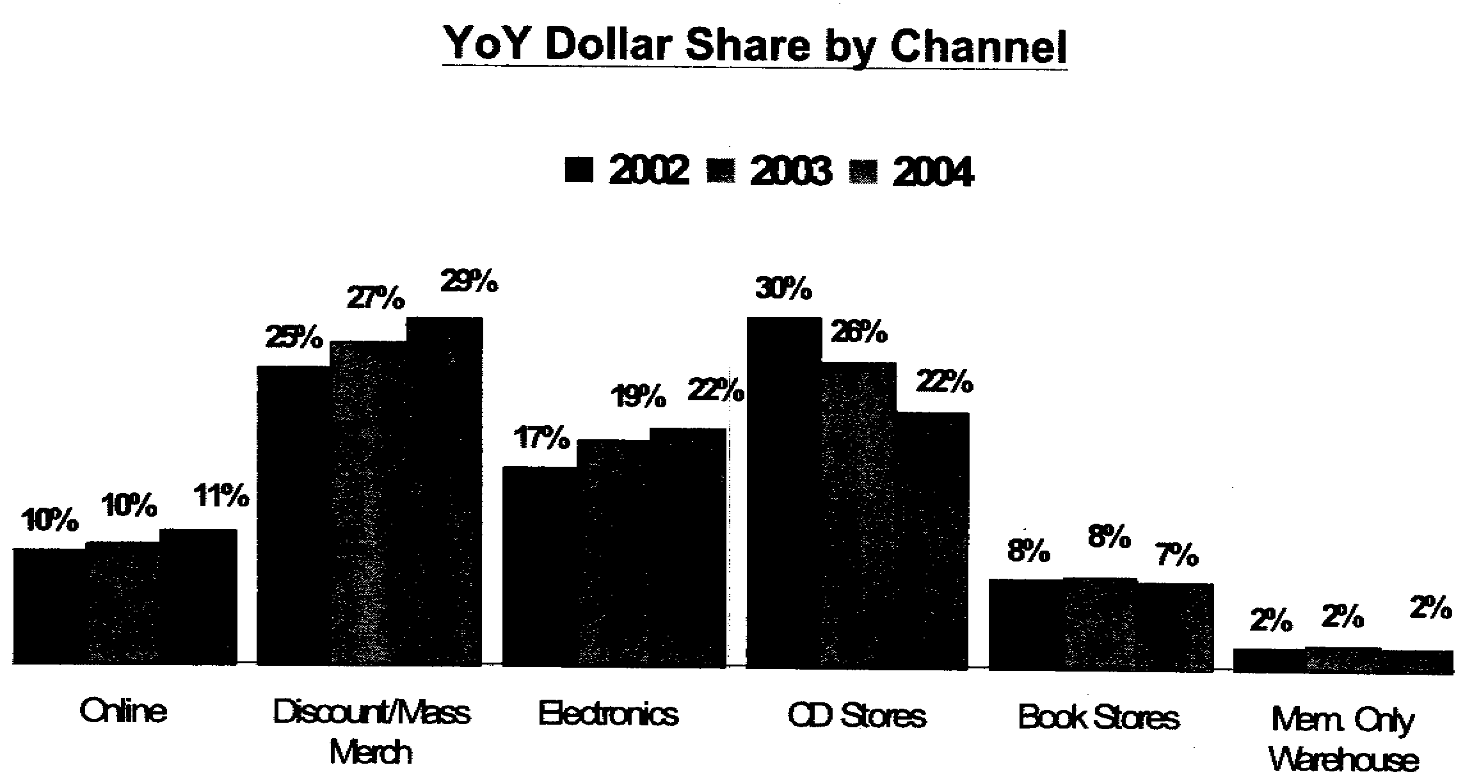


* includes singles and non-traditional retailers

Note: Prices based on consumer self-reporting

Market Summary: Channel shift continues

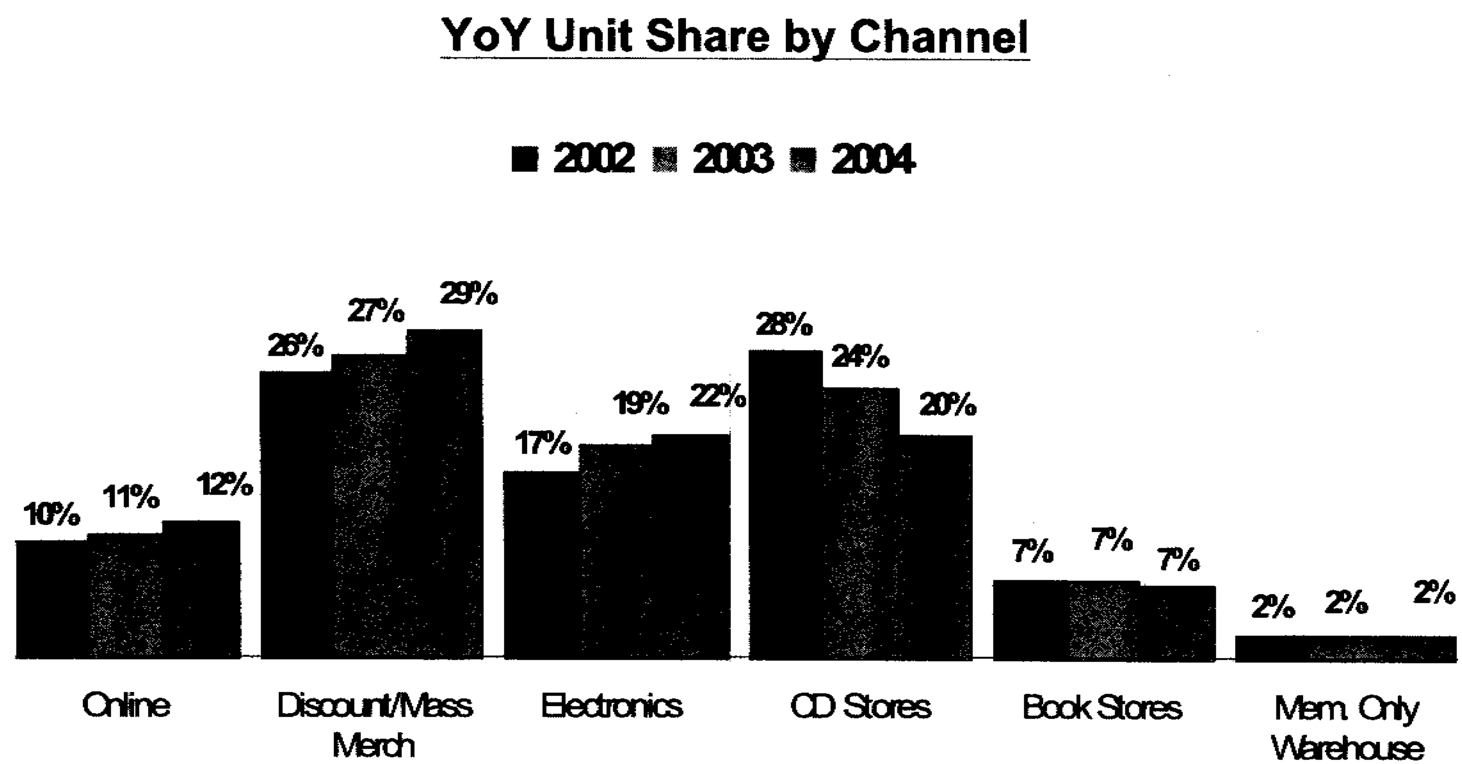
CD Stores continued to concede dollar share to Big Box and Online retailers, dropping another 4 ppts in 2004.



Source: NPD MusicWatch; Full-length CD

Market Summary: Channel shift continues

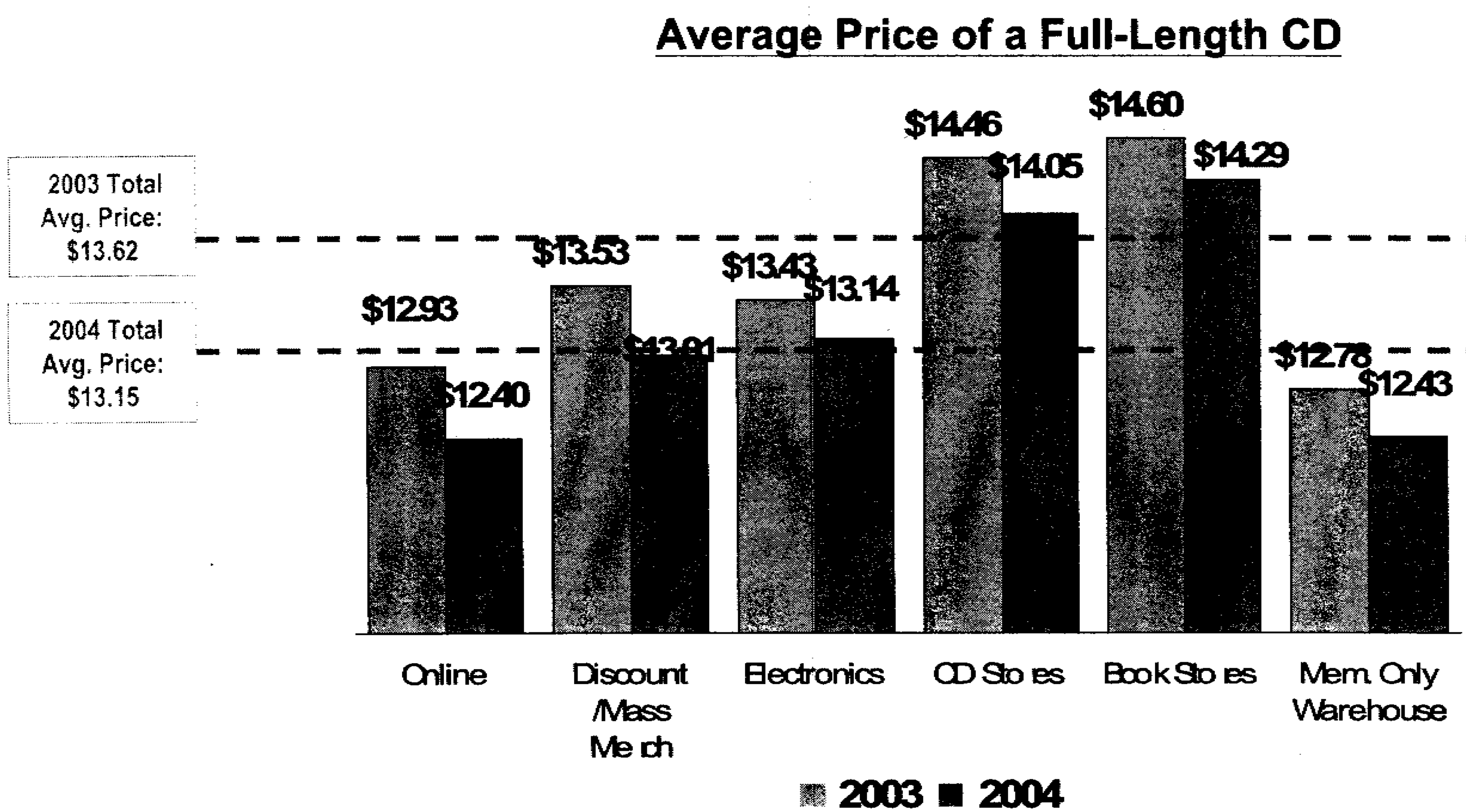
Online's unit share is slightly higher than its dollar share.



Source: NPD MusicWatch; Full-length CD

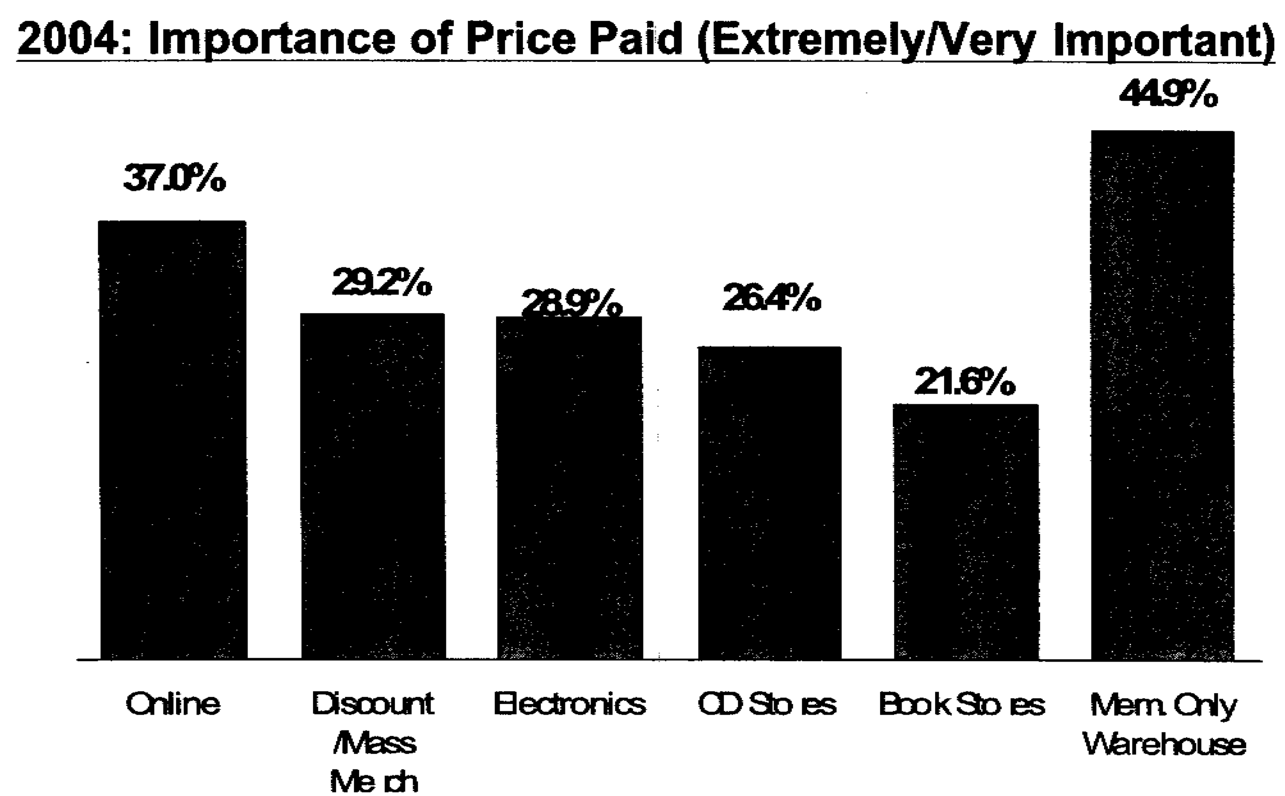
Market Summary: Pricing

The online channel made the biggest price cuts between 2003 and 2004: -\$.53, or a -4.1% drop in price for the average full-length CD. Discount/Mass Merchants were not far behind, with a -\$.52 cut.



Market Summary: Pricing and importance

Not surprisingly, the channels with the lowest prices (see previous slide) are the channels where price played an important role in the consumer's decision to purchase. Notably, only one in five Book Store patrons said price was important.

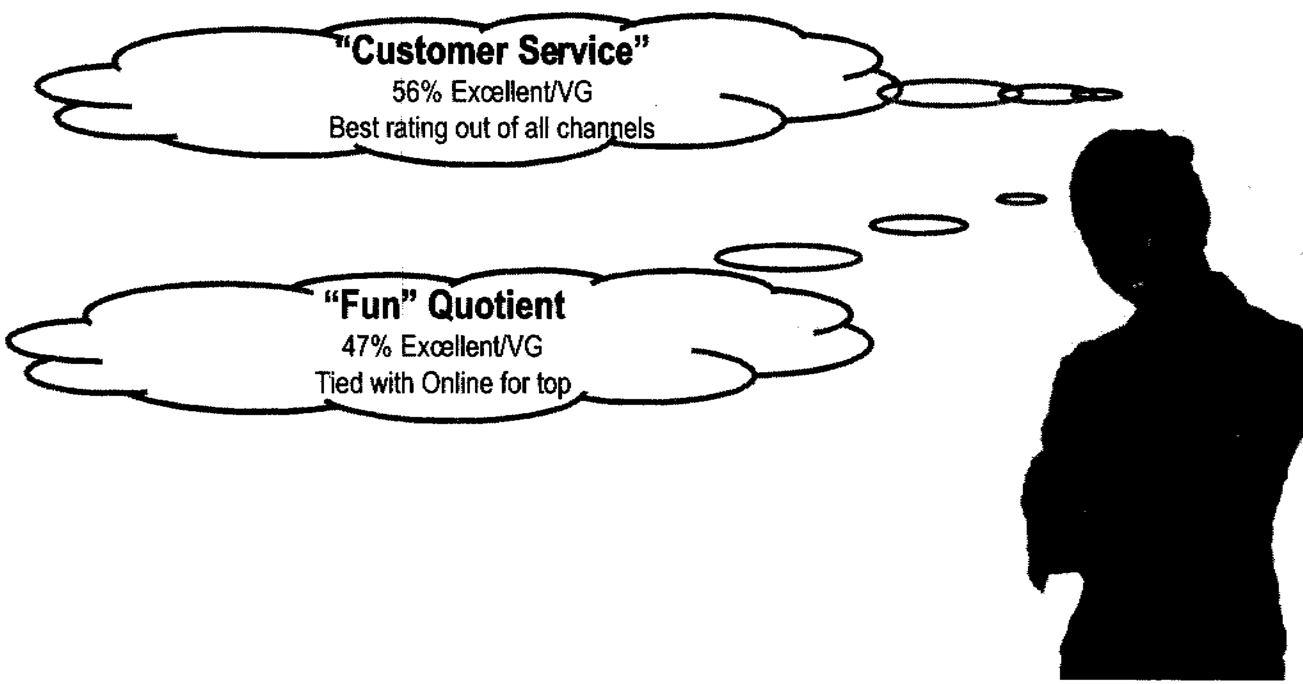


Market Summary: Pricing and importance

Book Stores rank high in retail satisfaction categories that are crucial to their particular customer. Takeaway: There are some things more compelling than price, if you can find them.

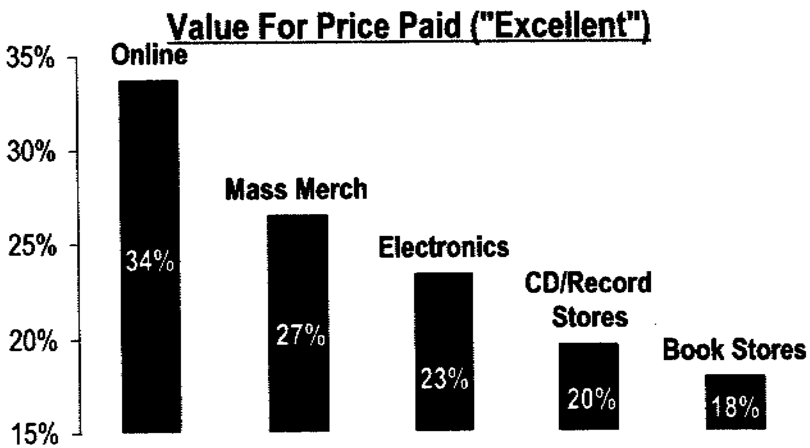
When asked about their shopping experience...

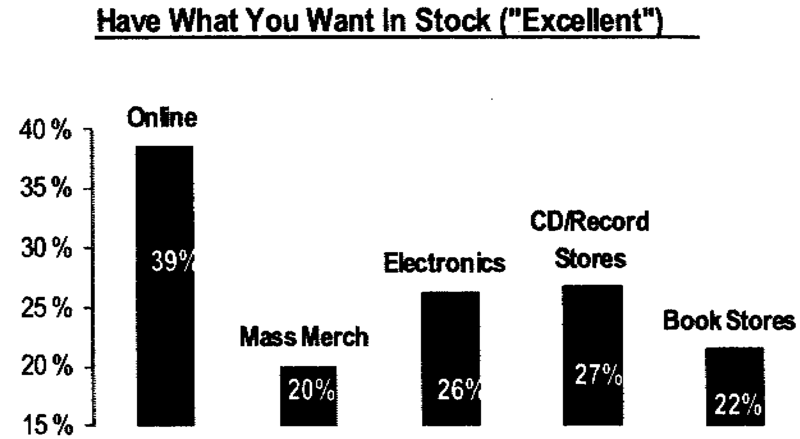
[redacted]

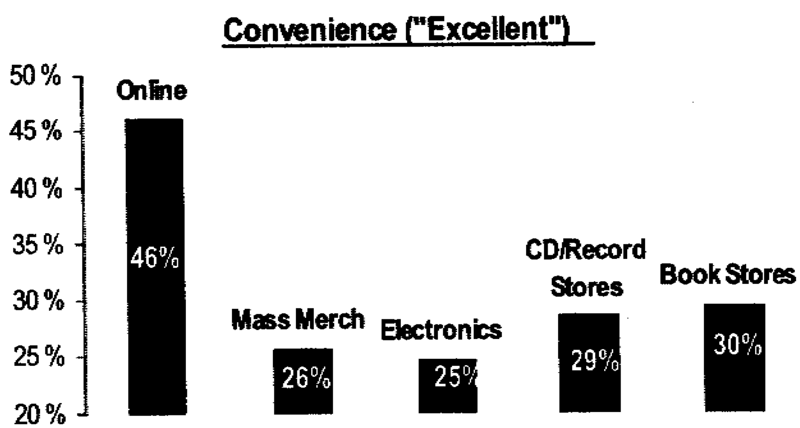


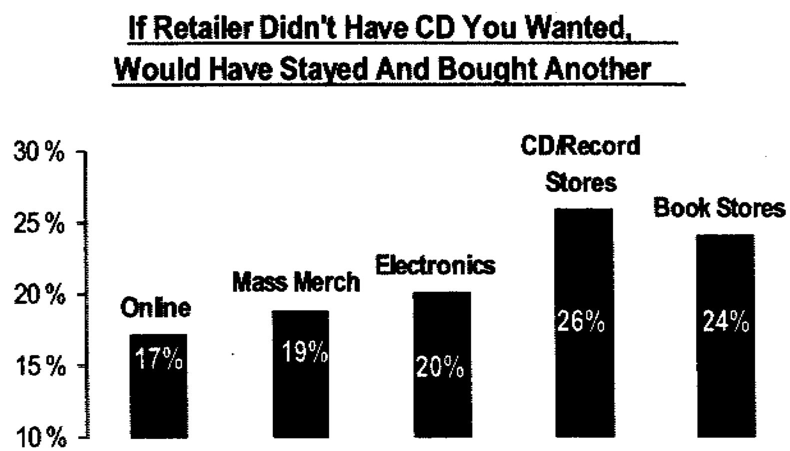
Market Summary: Pricing and importance

On the other hand, Book Stores rank low in traditionally important categories like value for price paid, selection and convenience… but they're still high in retailer loyalty (bottom right). Again, as shown in the previous slide, they pay attention to the things that count for their customers.



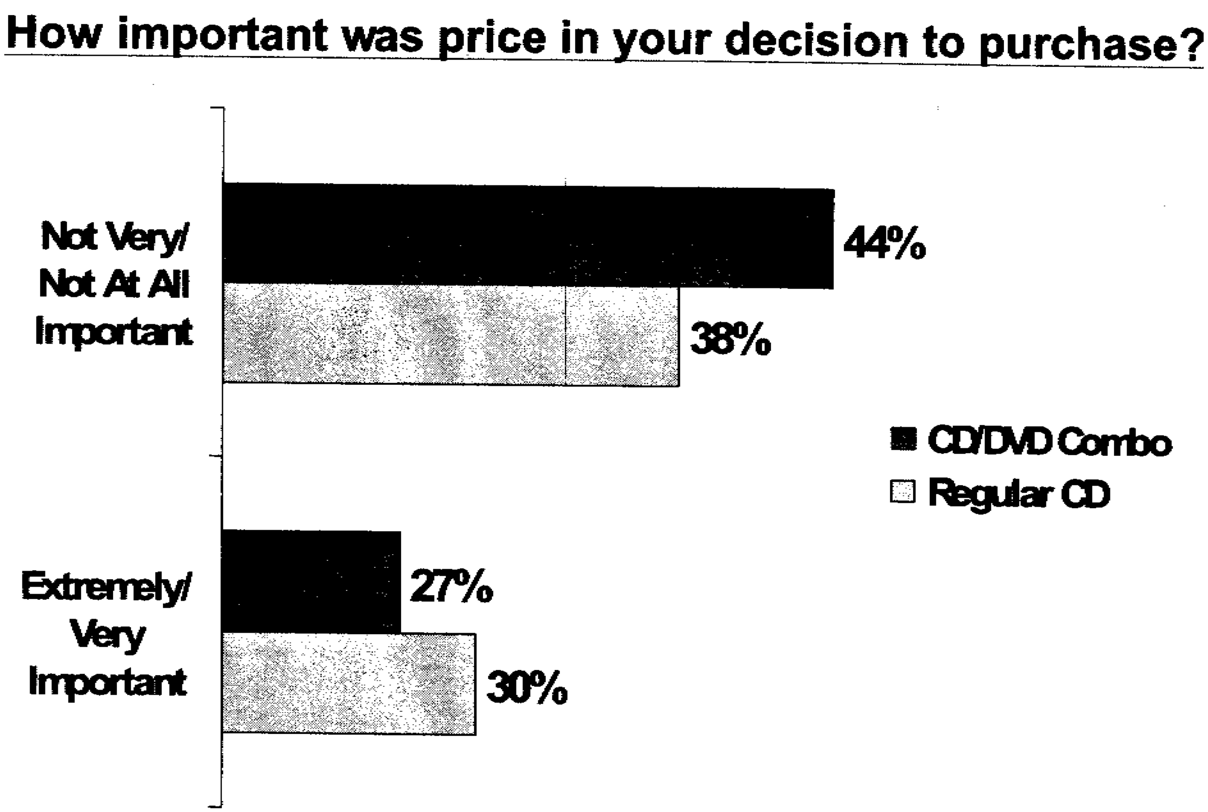






Market Summary: Pricing and premium content

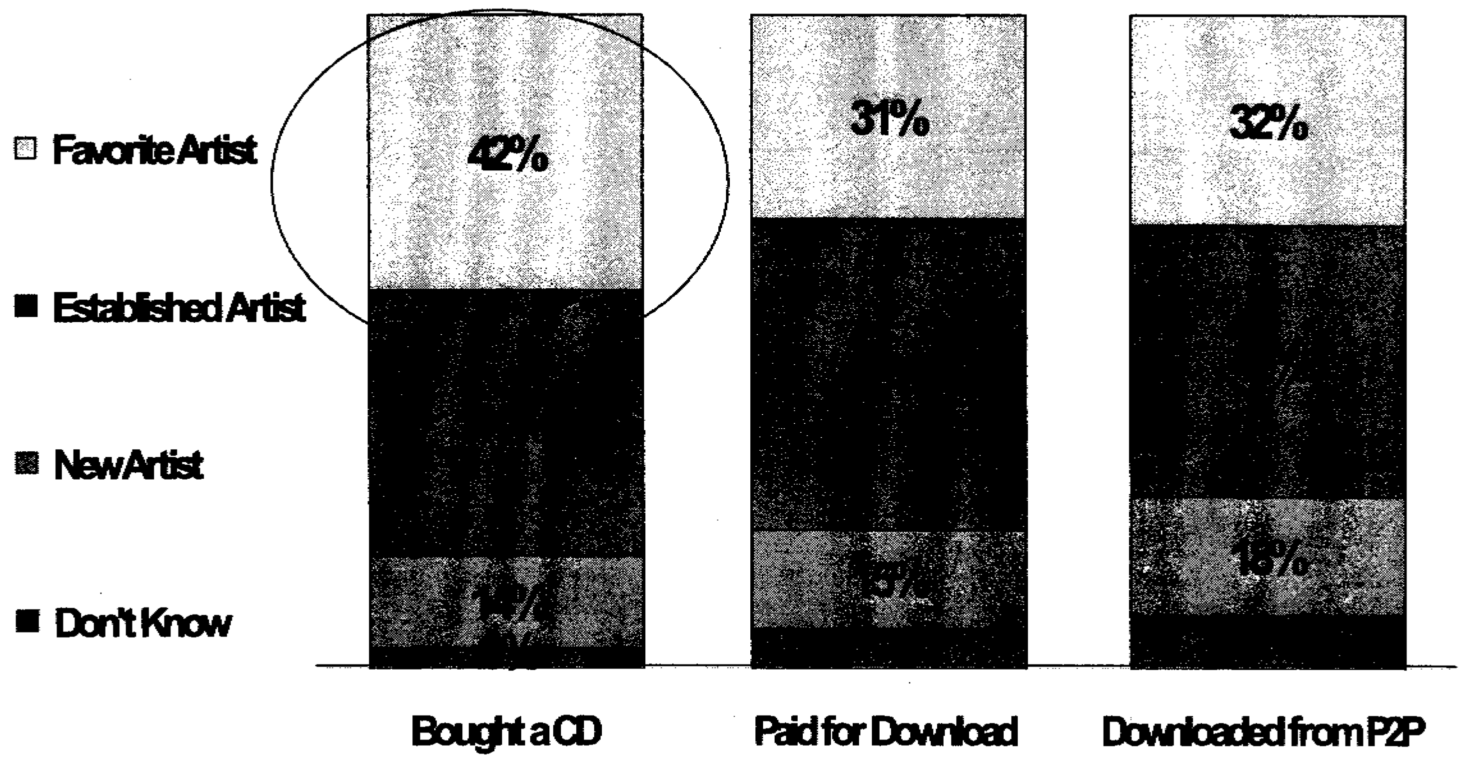
Price is less of an issue for consumers who purchase premium content. Here, buyers who purchased a CD/DVD combo (2 separate discs packaged and merchandised together) said that price was considerably less of a factor in the purchase decision than buyers who purchased a regular CD.



Market Summary: Physical music and favorite artists

As other avenues for sampling music become more widespread, consumers are less inclined to take a chance on a CD by a new artist. When they do buy a CD, it's more likely that it is by a favorite artist.

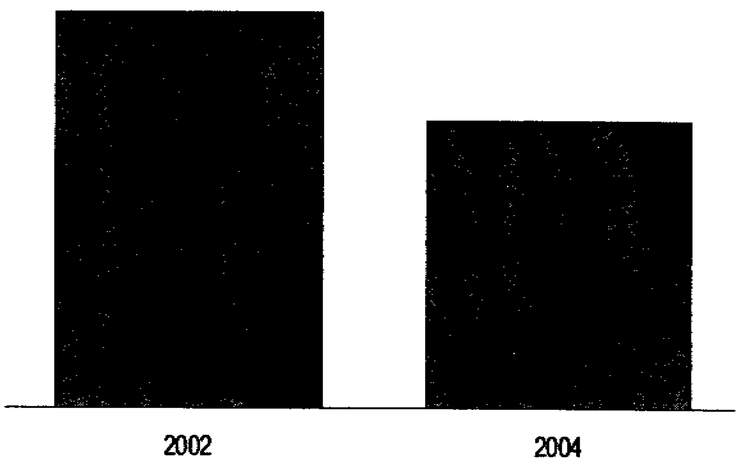
What kind of artist did you acquire the last time you...



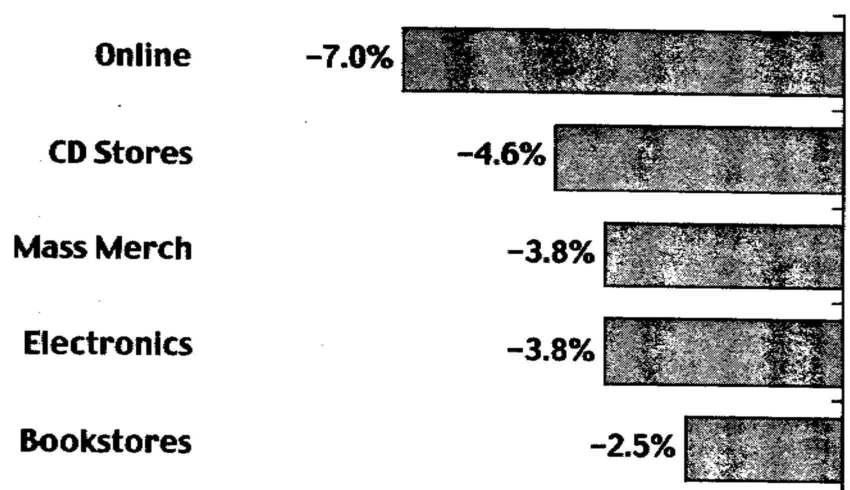
Market Summary: The pricing challenge - CD Stores

The CD Store channel's -7.5 ppt unit share decline over the past two years comes despite having dropped prices more than any channel other than Online.

Unit Share of CD Stores: 2002 v. 2004



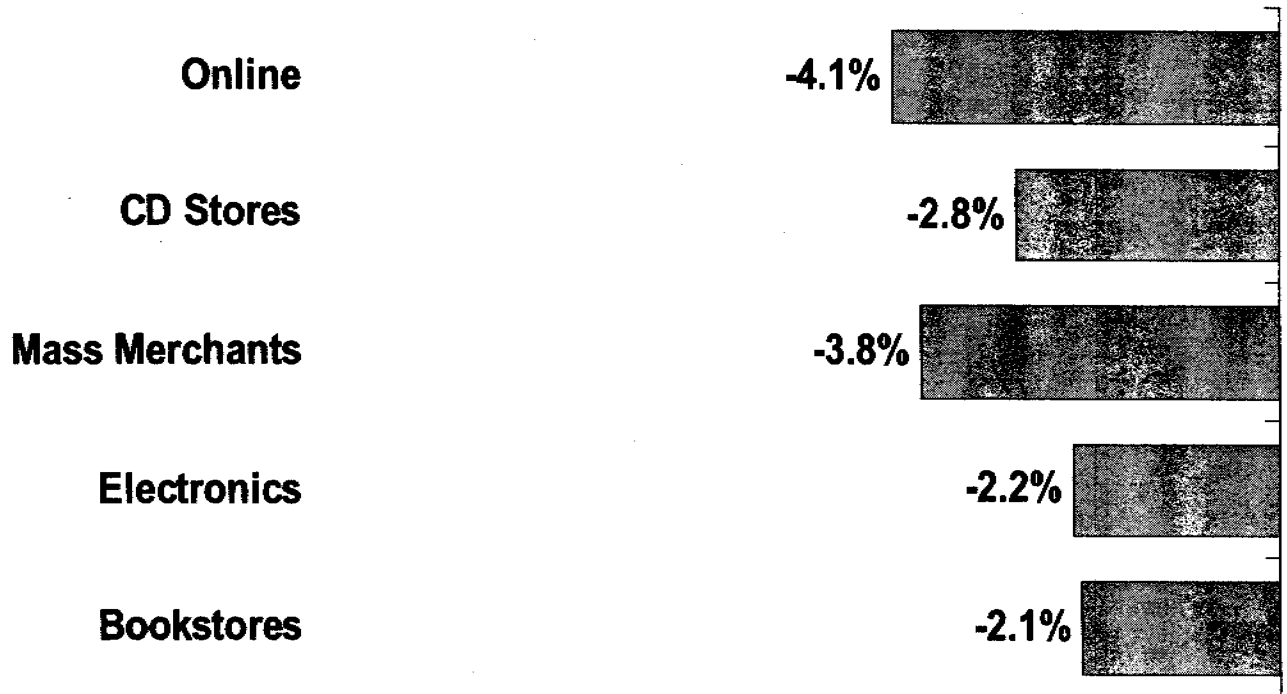
Percentage Price Change From 2002 to 2004



Market Summary: More on price decreases

Looking at a one-year period (as opposed to the two years shown in the previous slide), Mass Merchants dropped their average prices more than CD Stores - or any other channel except for Online.

Percentage Price Change From 2003 to 2004



Market Trends: Age Groups By Channel

The 25-34 age group is leaving CD Stores for Mass Merchants, Online and Electronics. The Electronics channel is dipping slightly among thirtysomethings and fortysomethings.

Age Group Share By Channel *

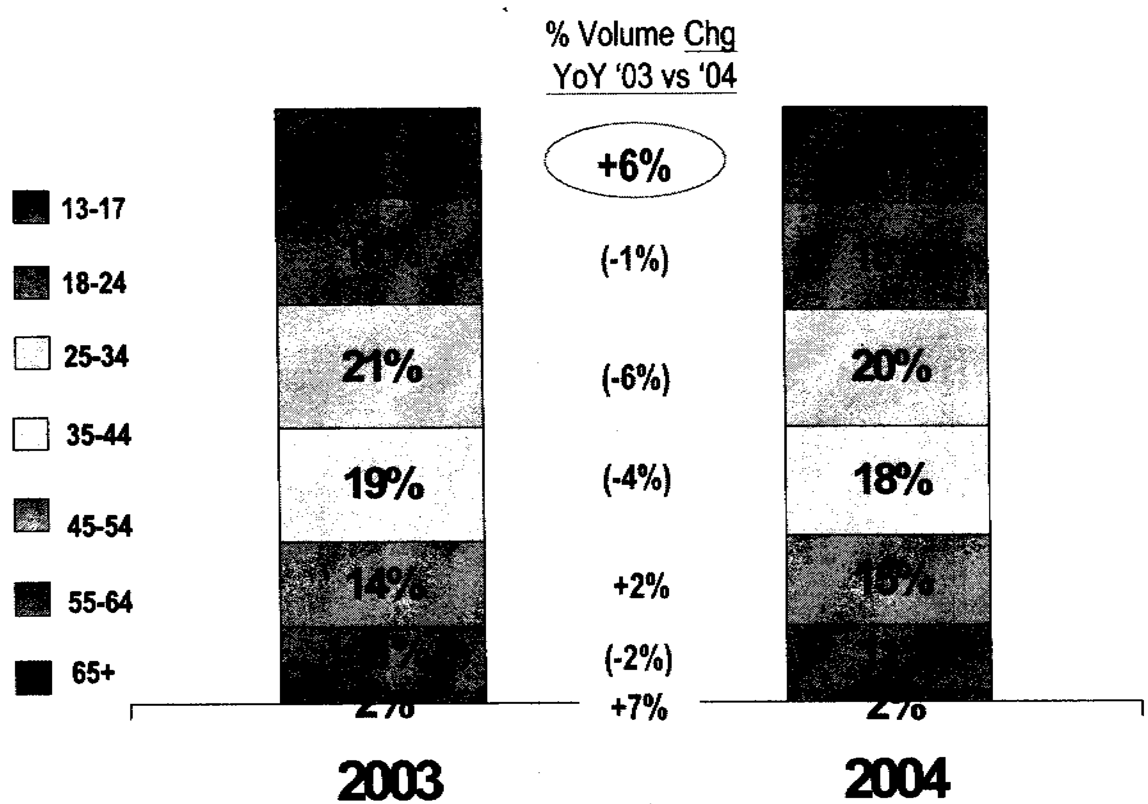
		18-24			35-44			55-64		
Retail Channels	[redacted]	2004	▲ YoY	[redacted]	2004	▲ YoY	[redacted]	2004	▲ YoY	[redacted]
Online	[redacted]	9.7	1.1	[redacted]	13.8	1.2	[redacted]	15.8	0.3	[redacted]
Mass Merchants	[redacted]	24.8	1.6	[redacted]	30.5	1.4	[redacted]	30.2	1.7	[redacted]
Electronics	[redacted]	25.4	1.3	[redacted]	18	(0.2)	[redacted]	13.3	0.3	[redacted]
CD Stores	[redacted]	24.5	(4.8)	[redacted]	18.7	(3.1)	[redacted]	14	(1.9)	[redacted]
Book Stores	[redacted]	6.2	0.0	[redacted]	6.2	(0.6)	[redacted]	9.1	(1.5)	[redacted]
Mem. Warehouse	[redacted]	1.6	0.8	[redacted]	2.6	0.0	[redacted]	3.3	(0.8)	[redacted]

** excludes "other"/non-traditional retail outlets such as Department & Convenience Stores*

Market Summary: Teen rebound and selection

Teens made a comeback to CD sales in 2004, with a sales volume increase of 6% and a share increase of 1%. And as shown in the next slide, the increase was driven at least in part by depth of selection.

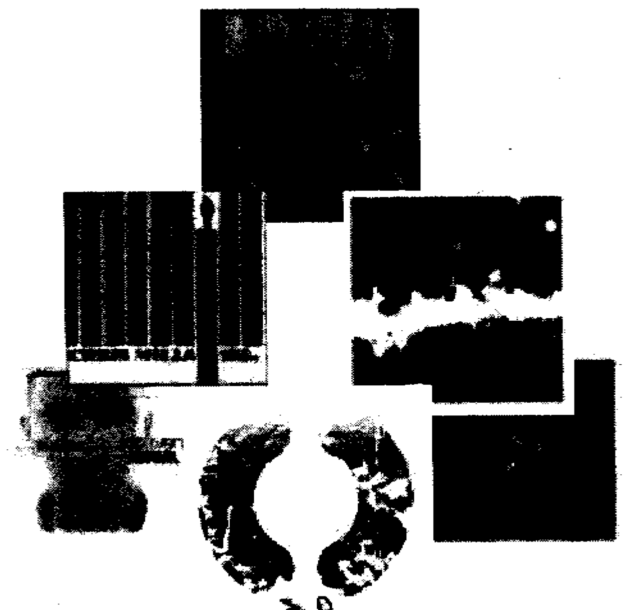
Unit Share By Age Group



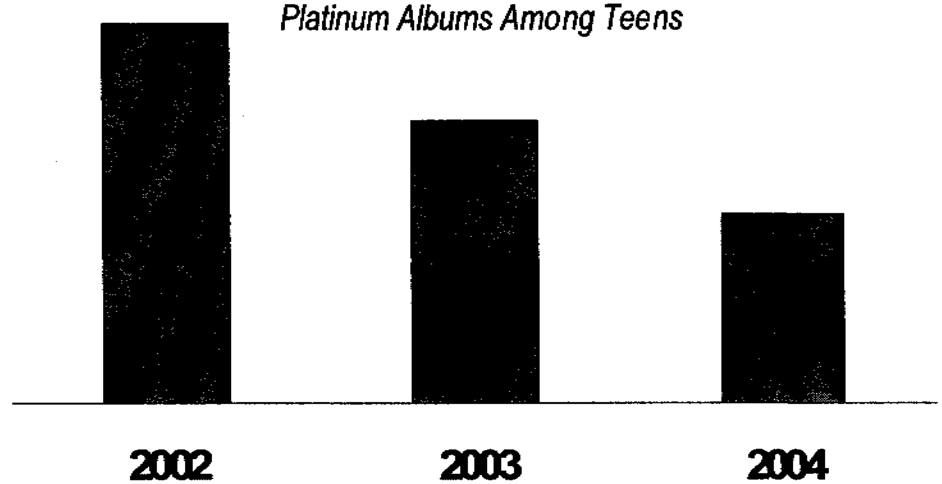
Market Summary: Depth of selection brings teens back

Revenues from teens are being driven less by a few platinum-selling CDs and more by many lesser-known CDs that sell less than 50k copies to that age group.

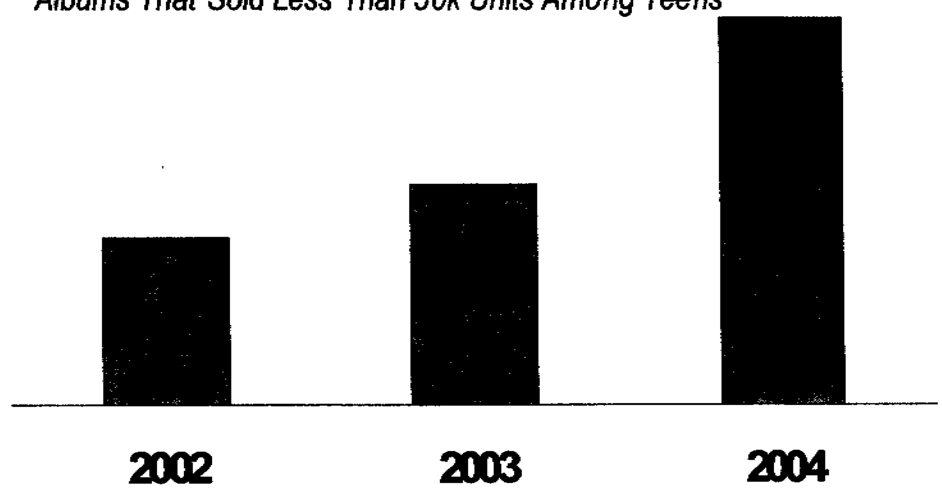
This trend should continue as the Internet facilitates word-of-mouth sales and makes more selection available.



Percentage of Total Sales
Platinum Albums Among Teens



Percentage of Total Sales
Albums That Sold Less Than 50k Units Among Teens

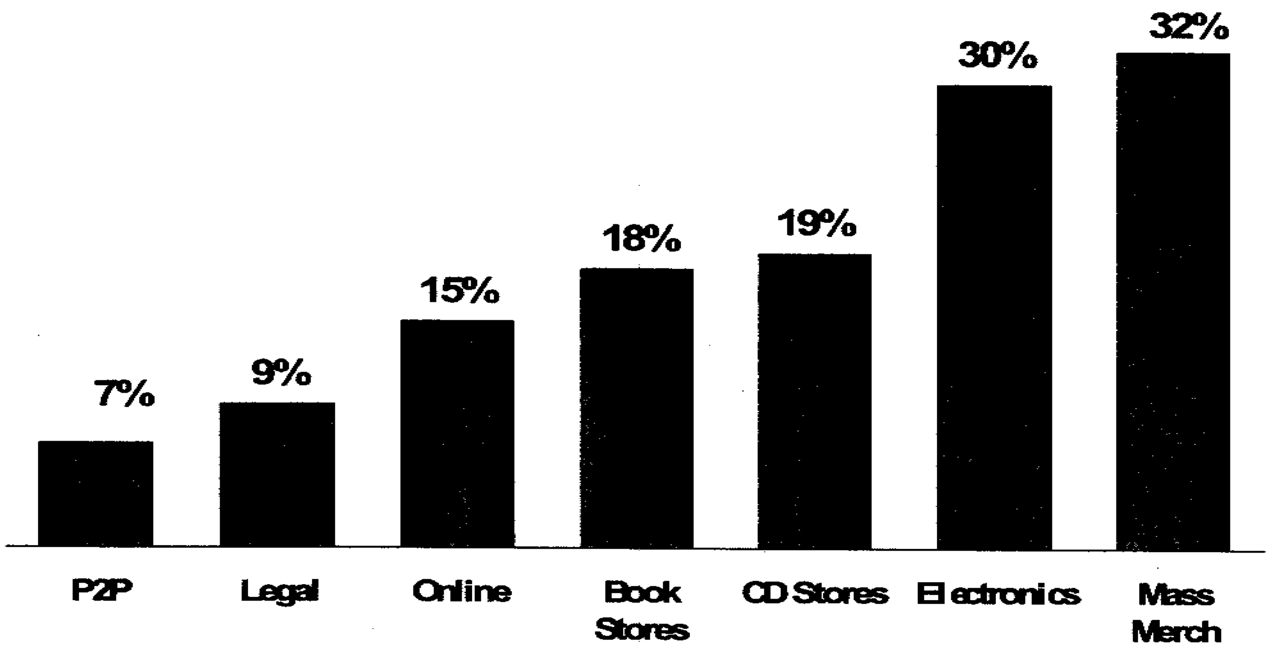


Market Summary: Selection and the channels

As shown below, the top 100 CDs accounted for 32% of sales at Mass Merchants. At the other end of the spectrum, the top 100 CDs only accounted for 15% of sales in the Online channel, and the top 100 songs accounted for less than 10% of downloads from P2P and legal digital music stores.

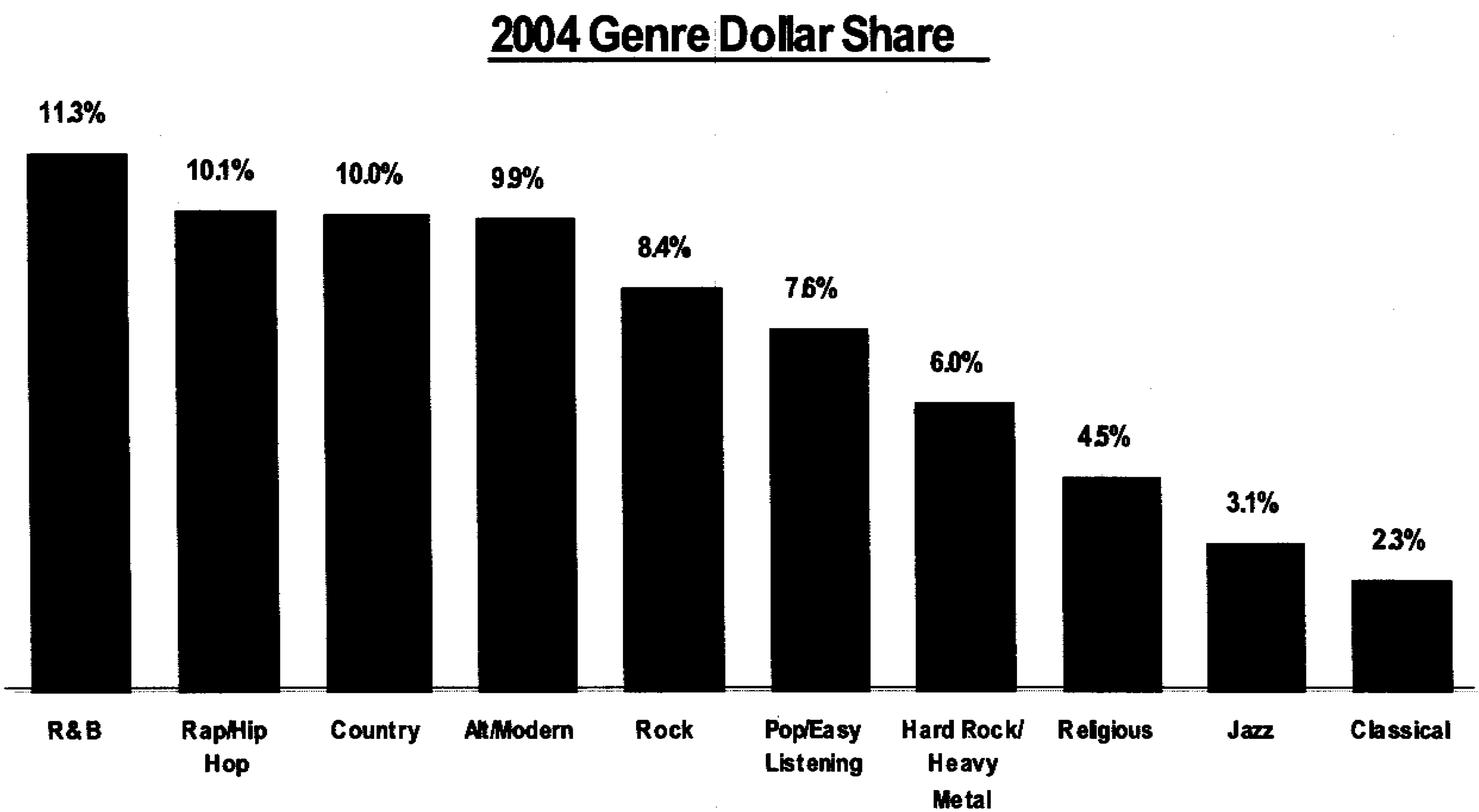
Top 100 Sellers - Unit Share of Total Sales/Downloads

(2004)



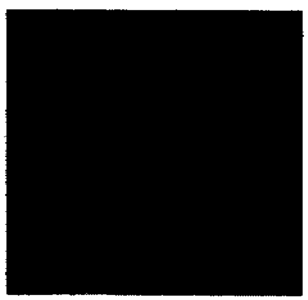
Market Summary: What are they buying?

R&B and Rap were the top genres in 2004, followed by Country, then the Rock sub-genres.

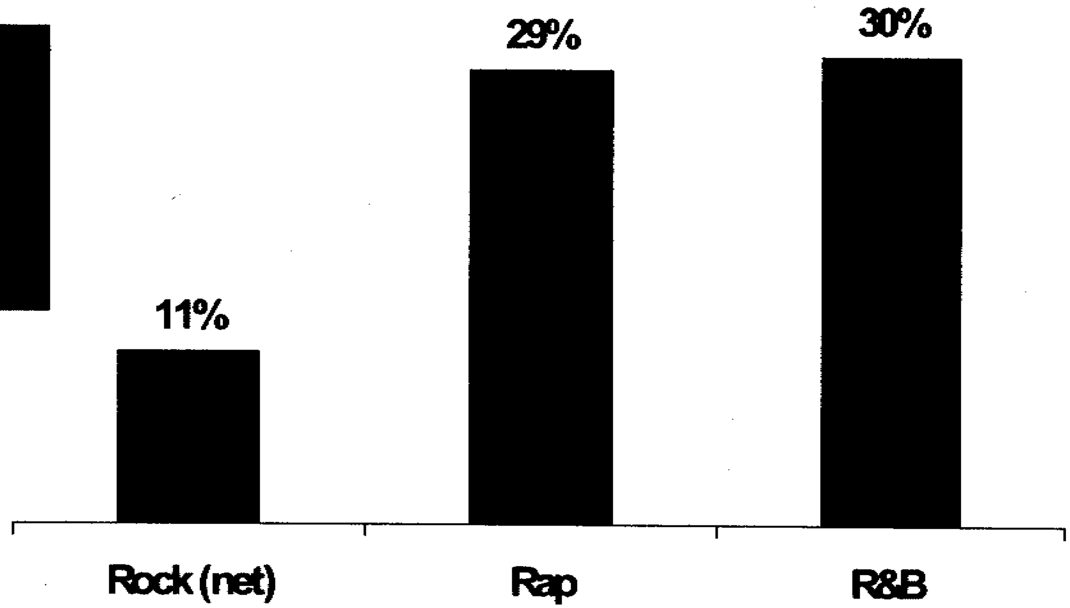


Market Summary: Rock is fragmented

Together, all of the Rock sub-genres (not shown in previous slide) outsold urban music. But since Rock is so fragmented, it's a challenge to attract a significant portion of that audience. Conversely, it's much easier to attract the lion's share of urban music buyers simply by carrying the top sellers. Shown below, the top 10 CDs in Rock (net - or sub-genres, included) accounted for only 11% of the genre's total sales. By comparison, the top 10 sellers in Rap and R&B accounted for three times as many sales in those genres.

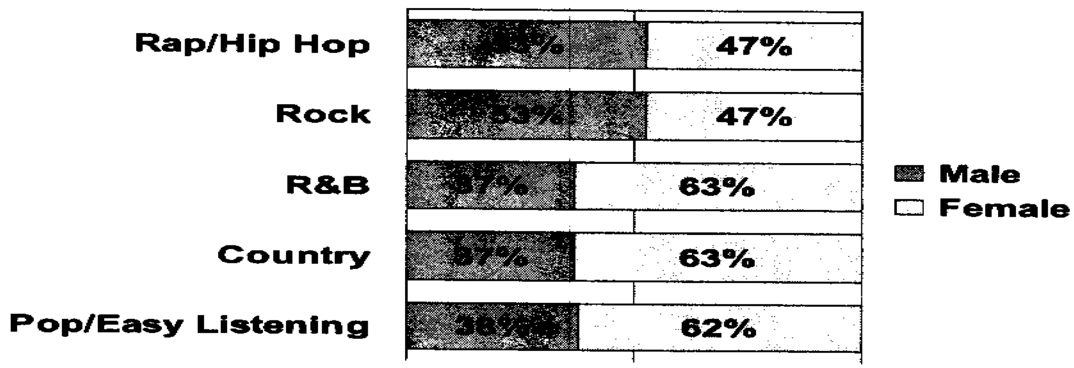


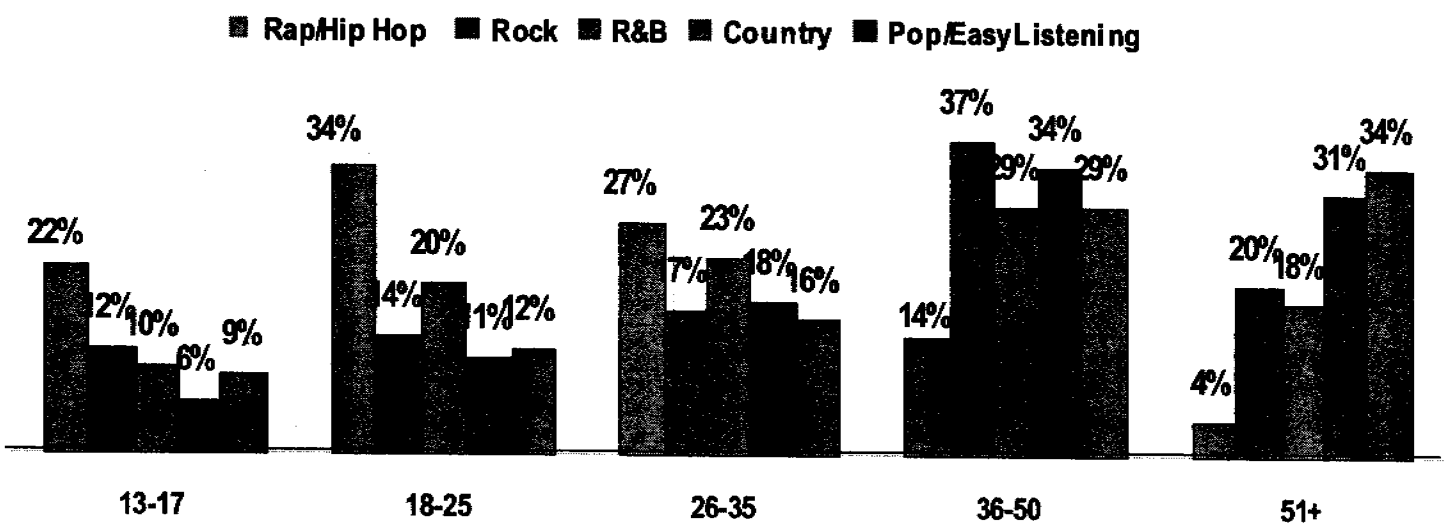
Top 10 Sellers - Share of Total Sales



Market Summary: Who Buys Which Genres

Demographic Profile Comparison of CD Buyers by Genre





Source: NPD Digital Music Study

Digital Music

- 2004 - A Market Summary
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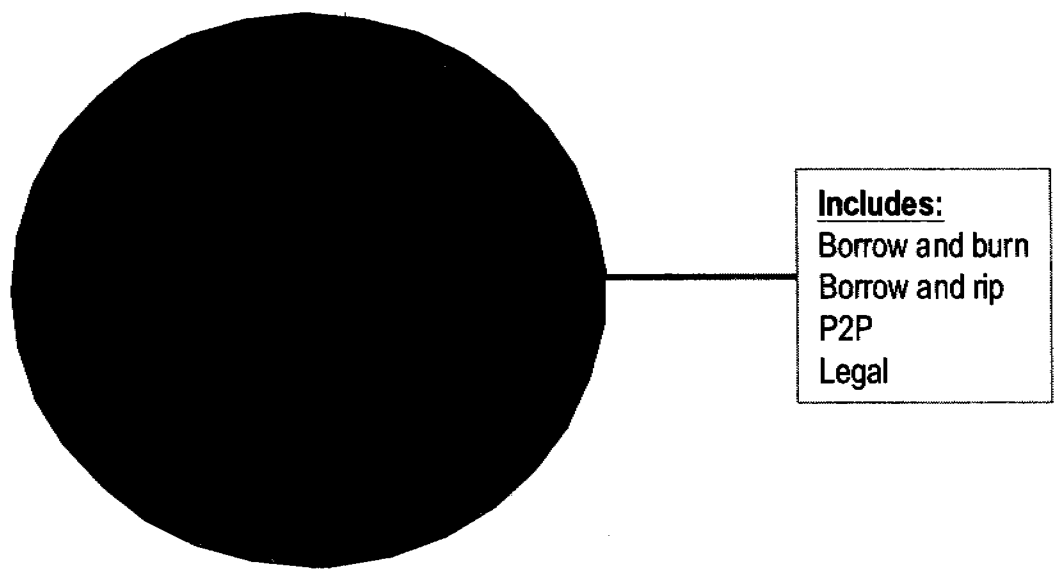
Digital Music: Quick bits

- Only half of music acquired in 2004 was through CDs. The rest came from digital music - legal services, p2p, and borrowing and ripping or burning CDs.
- Legal digital music consumers are also heavy physical buyers.
- Retailers can use legal digital music to overcome selection and sampling issues.
- Legal digital music consumers are more male and slightly younger than physical music buyers. Trial is driven largely by promotions and technology acquisition.
- Consumers see digital music as having a different value than physical music. They will often use digital to sample, and are more likely to buy the CD either when they are sure they would like to add it to their collection or when they are compelled by premium content.

Digital Music: Assessing the size of the market

Only half of all music acquired is via the purchase of CDs. Retailers need to make sure they're a part of that digital value chain. An additional challenge for retailers is that - - to stay in touch with their customers' tastes - - they need to know what those customers are doing with digital music.

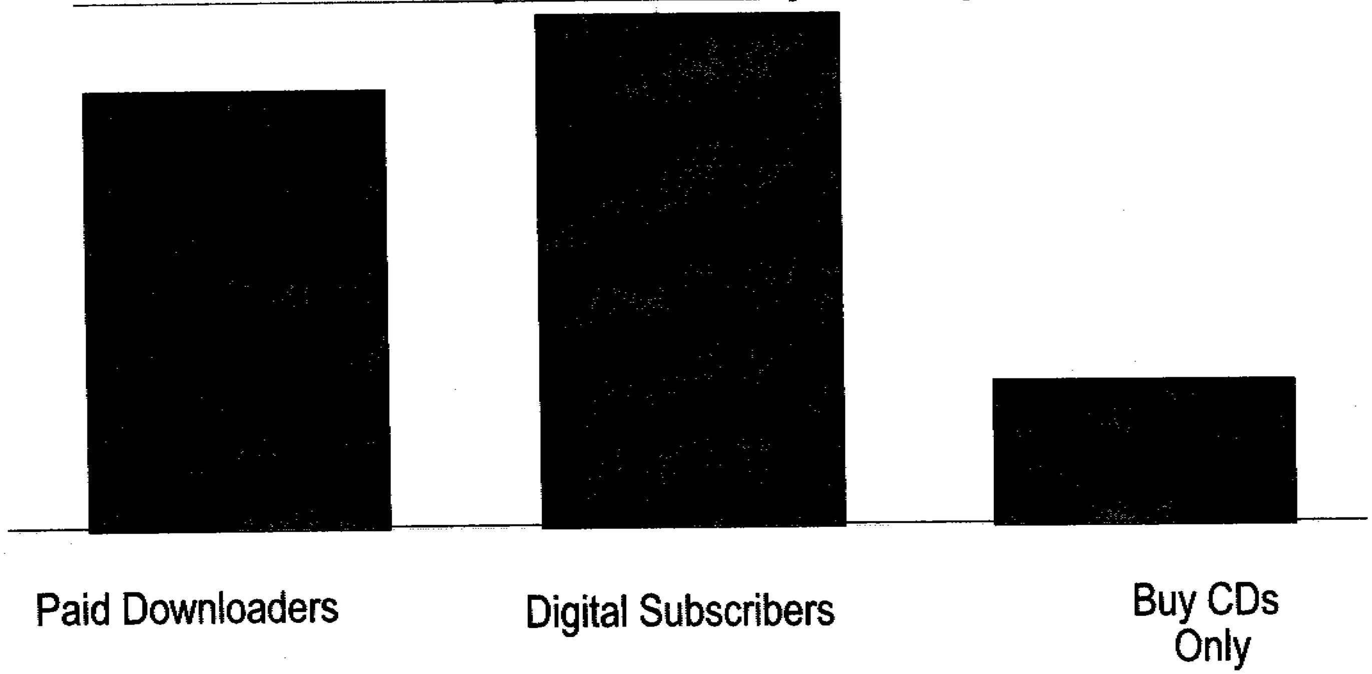
How Music Was Acquired
<u>In The Past 12 Months</u>



Digital Music: The good news is digital consumers are your heavy buyers

Consumers of legal digital music spend nearly twice as much on CDs as those consumers that only buy physical CDs. They spend more than three times on music overall as their physical-only counterparts.

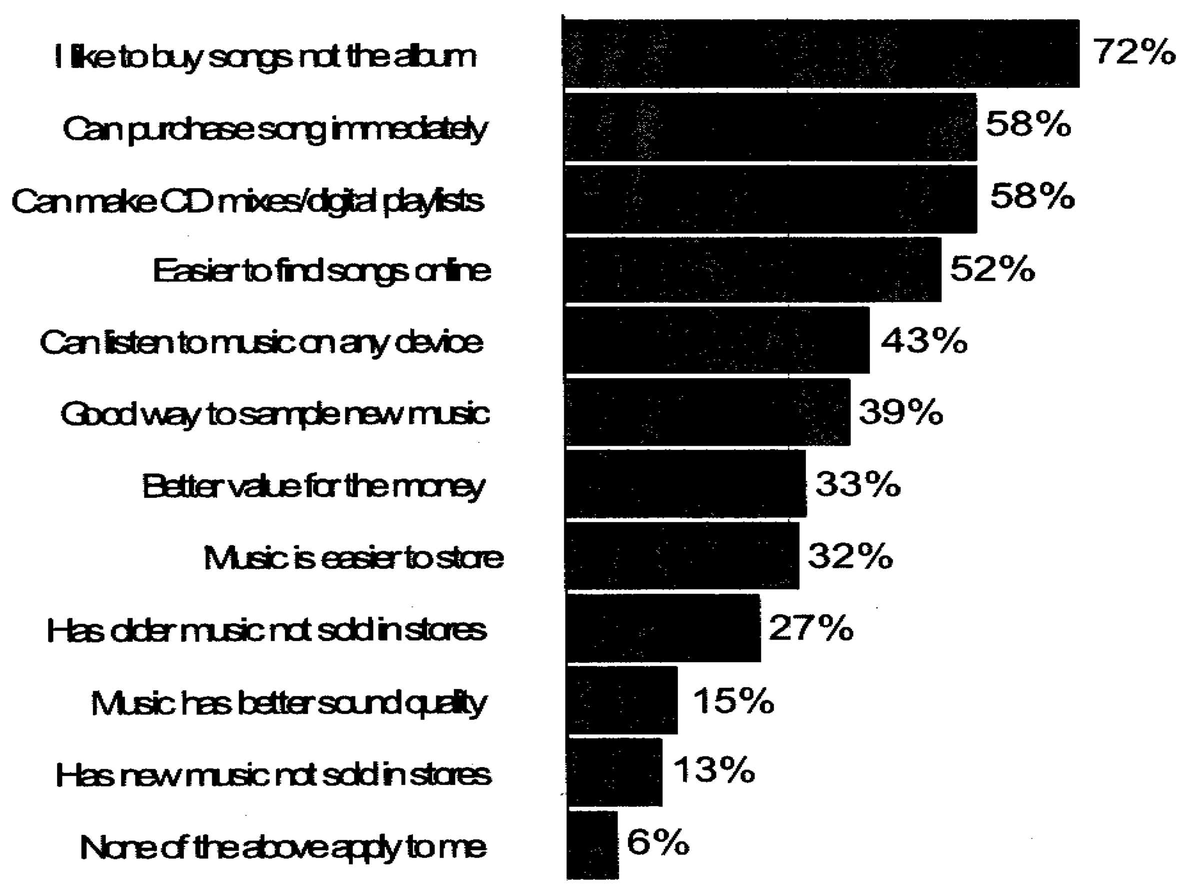
Estimated Per Capita Music Spending In Past 12 Months



Spending on CDs only:	$95	$92	$48

Digital Music: Perceived advantages over physical include a la carte option, larger selection, ability to sample

"What are the main reasons you would buy digital instead of physical?



Digital Music: Use per retail channel

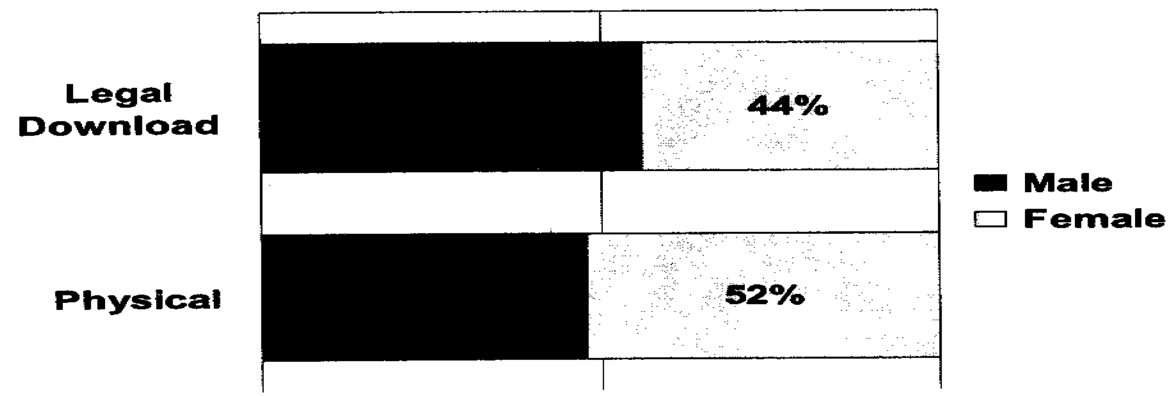
Not surprisingly, customers of the Online channel are nearly three times as likely to have paid for digital music as Mass Merchant customers.

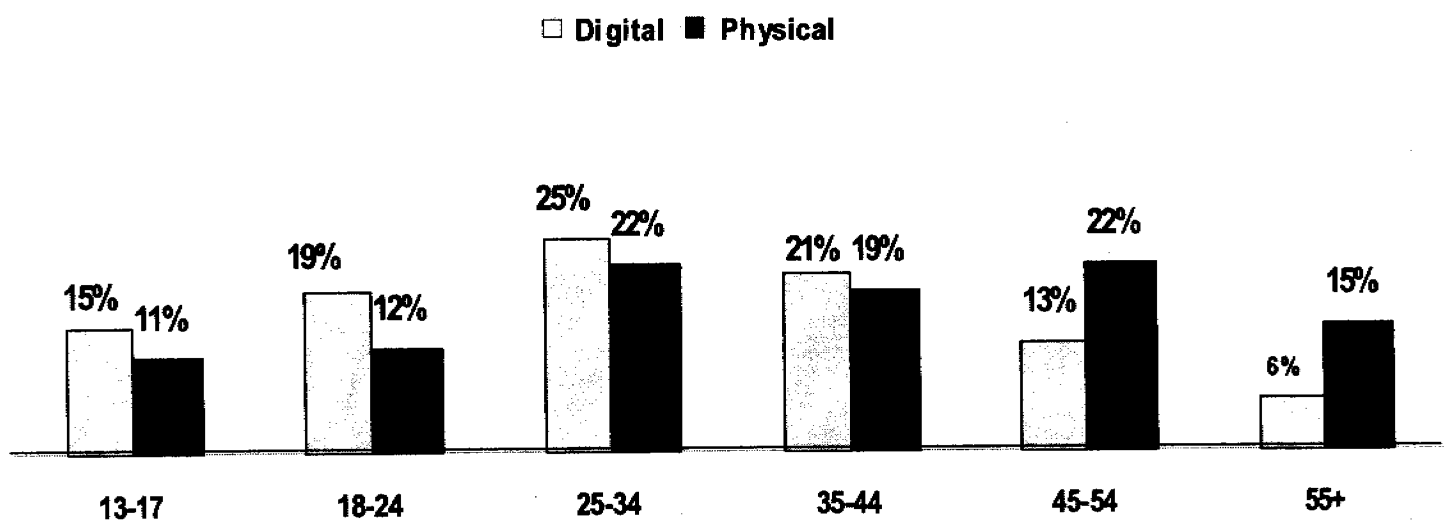
Channel	Percent of Customers Who Paid For Digital Music	Share of Physical Sales
Online	22%	11%
Bookstores	14%	7%
Electronics	12%	22%
CD/Record Stores	11%	22%
Discount/Mass Merch	8%	29%

Source: NPD MusicWatch 2004, NPD Digital Music Study

Digital Music: Who is the legal digital consumer?

Demographic Profile Comparison of Music Buyers: Legal Download vs. Physical





Digital Music: Profile of legal digital music buyers

(bought digital music at least once every 6 months)

DEMOGRAPHICS

- 80% have **broadband**
- **Higher proportion of males**
- **High income**
- **Alternative, Classic Rock, 80s/90s, Pop, and Soft Rock** are popular **genres.**

BEHAVIOR

- **Technology is driving adoption**- e.g., faster internet access, better computer, digital/mp3 player.
- 34% started buying digital because of a **promotion**- 53% of those who started buying **4-6 mos. ago** were encouraged by a **promotion.**

DRIVERS

- Drivers for buying digital over CDs: **Like songs, not the album, Can buy immediately, Can make CD mixes/ playlists, Easier to find music online**
- Drivers for buying CDs over digital: **Long-time fan,** want for collection, **Like most songs,** want for collection, CD **liners/lyrics/notes**

IMPLICATIONS

Differentiate the CD as a more valuable proposition than digital music.

Consider bundling CDs and downloads.

- Present bundled CD offers while they are on-site for artists that have a strong fan base.

Meet your entertainment consumer

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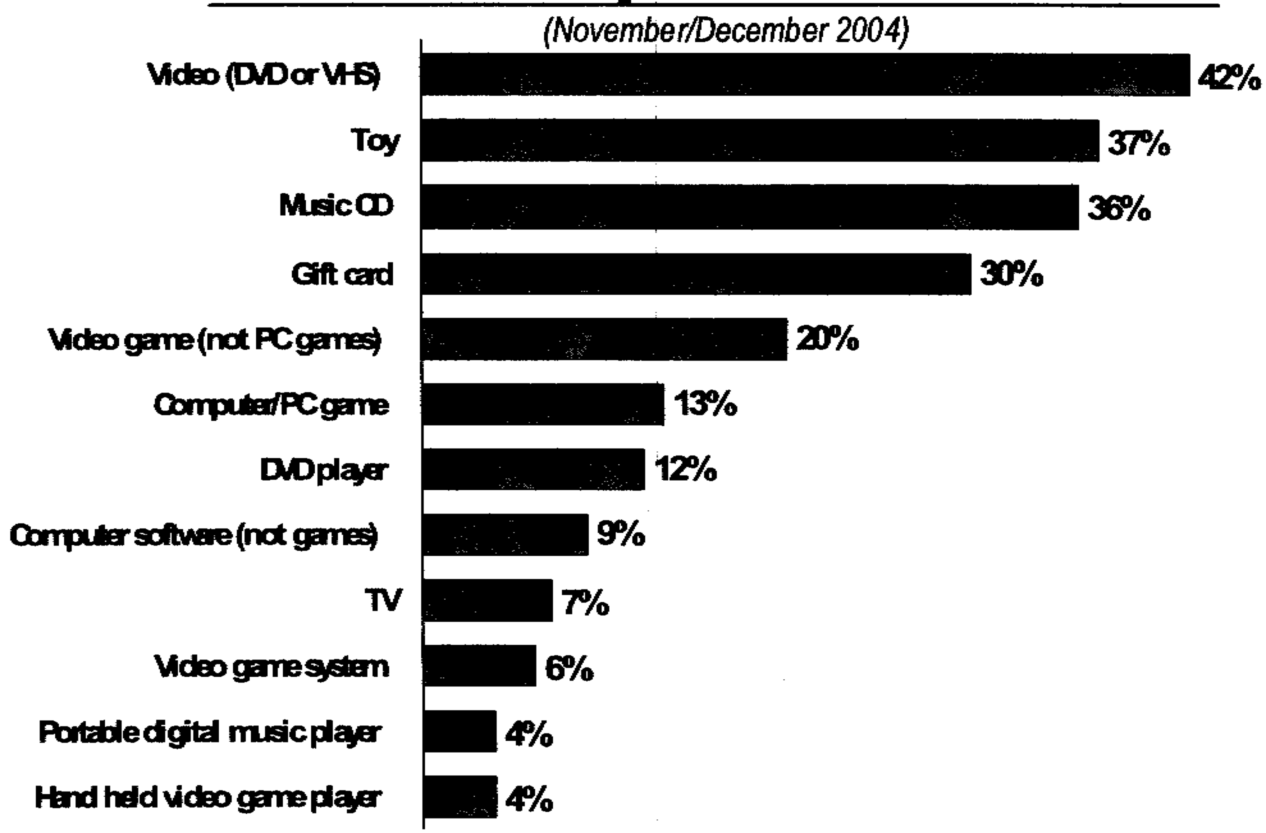
The Entertainment Consumer: Quick bits

- Music took a backseat to DVDs during the holiday season.
- The 25-34 age group is the most affected by wallet share competition - both with DVDs and with technology items like MP3 players.
- College age is a better market for CDs than for DVDs, and CD buyers skew 5 ppts more African-American. Beyond that, the audiences are very similar.
- The Discount/Mass Merch channel accounts for nearly half of all DVD sales. In a relatively young market, though, there is likely to be diversification over the next year.
- In-store placement/promotion is extremely effective for DVD sales.
- DVD buyers are in "collection" mode. Retailers and distributors are doing a solid job of using that to their advantage, explicitly pushing the "must have" releases in their marketing.
- 29% of DVD buyers also shopped for music during the same shopping trip.

The Entertainment Consumer: Wallet share competition

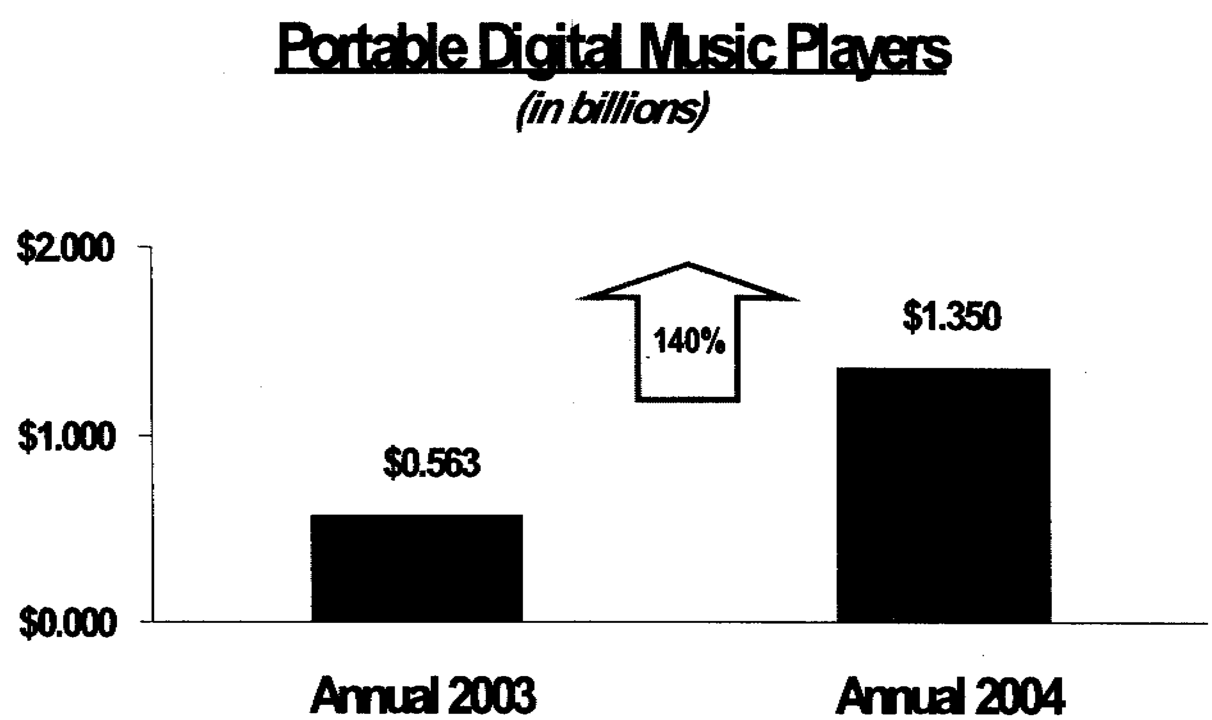
Music was the third most-purchased item in the entertainment category during the holiday season behind DVDs and toys. Big ticket items like TVs, DVD players and portable music players also placed on the list.

Items Purchased by Entertainment Consumers



The Entertainment Consumer: The growing digital habit

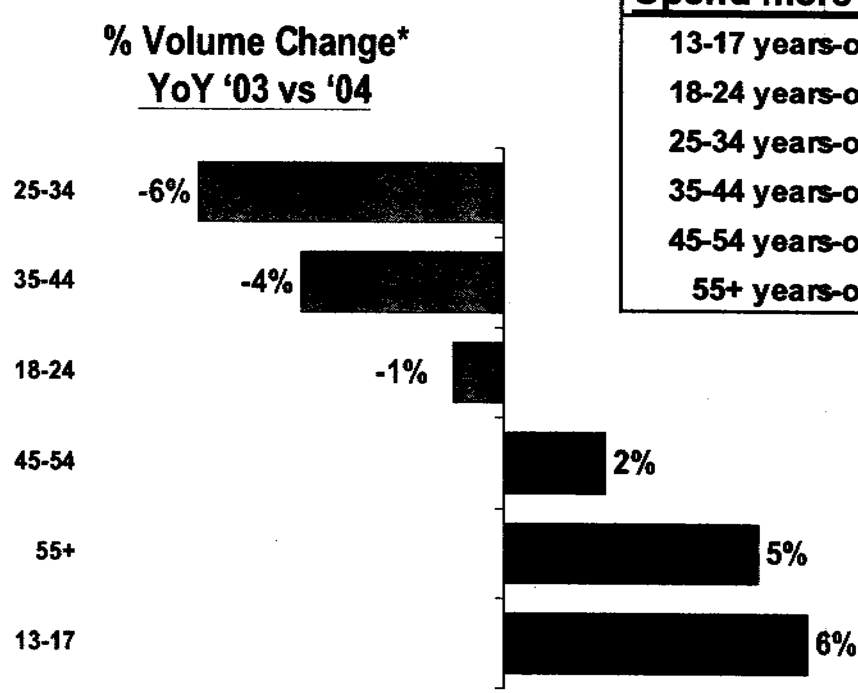
Portable Digital Music Player dollar sales grew to $1.3B this year.



Source:NPD Techworld; POS Data - Portable Digital Music Player Sales

The Entertainment Consumer: Impact on CD sales

Wallet share competition appears to be having the biggest impact on 25-34 year-olds. That age group's purchase volume dropped 6% from 2003. When asked why they purchased less music, "Spent more money on technology" and "Spent more money on DVDs" rated higher than with any other age group.



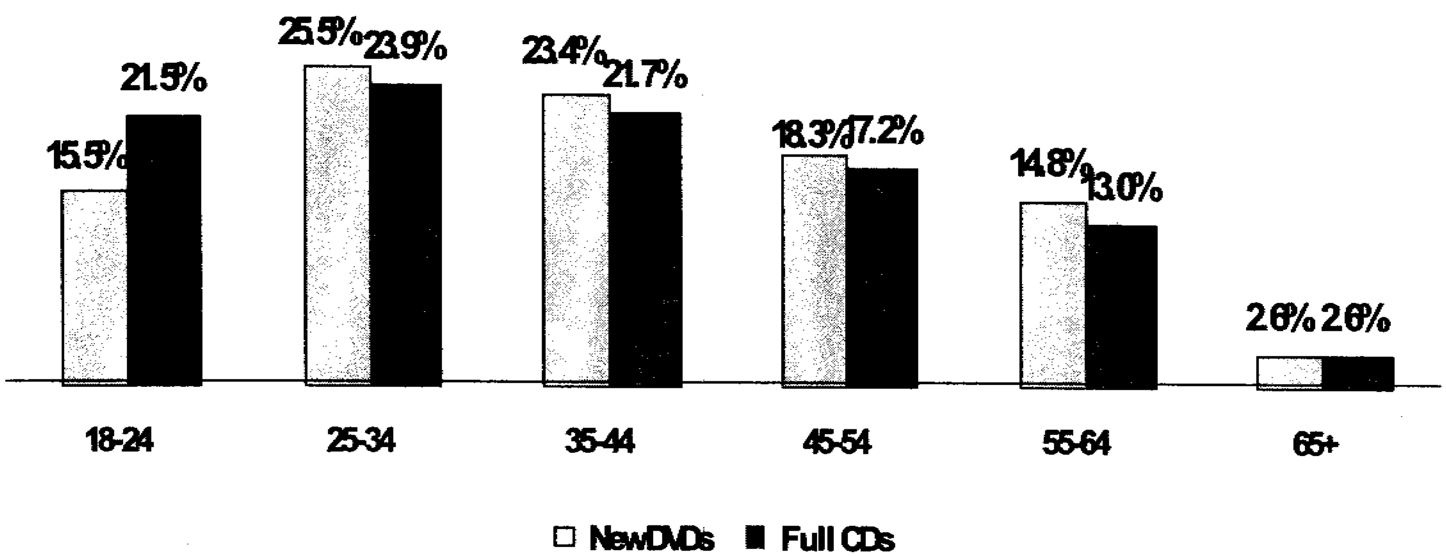
	Spend more on technology	Spend more on DVDs
13-17 years-old	29.3%	25.9%
18-24 years-old	32.6%	26.8%
25-34 years-old	34.7%	30.4%
35-44 years-old	20.5%	28.1%
45-54 years-old	26.2%	27.5%
55+ years-old	24.3%	16.0%

* full length CD only

The Entertainment Consumer: DVD audience

CD sales skew slightly younger than DVD sales. The top age group for both is 25-34. As shown in the previous slide, this may be cannibalizing some music sales.

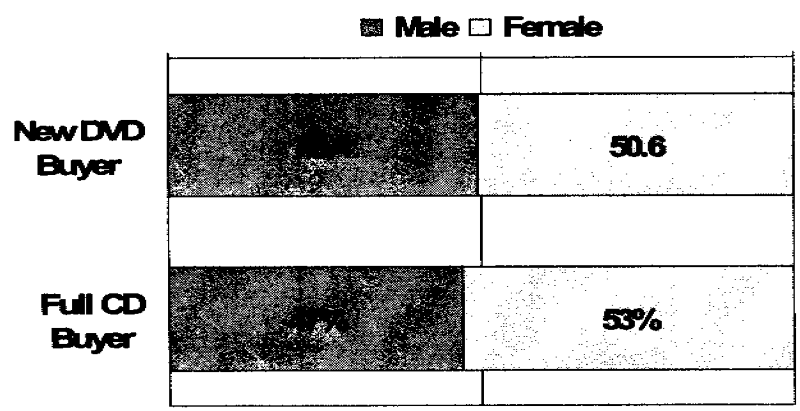
Share of CD/DVD Sales By Age Group

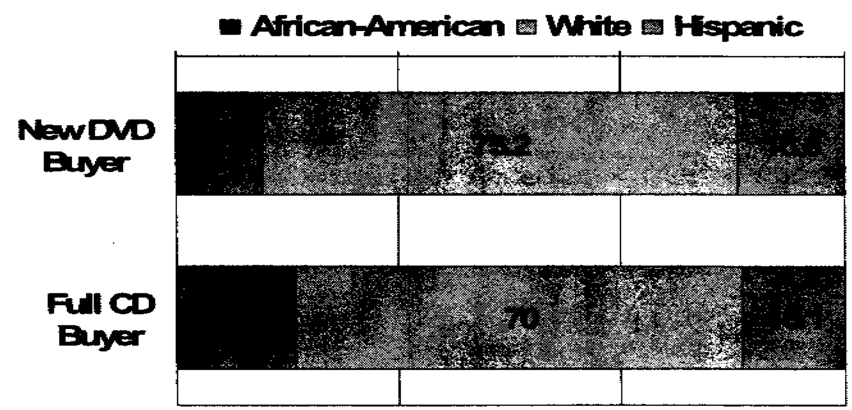


Source: NPD VideoWatch, NPD MusicWatch - 2004

The Entertainment Consumer: DVD audience

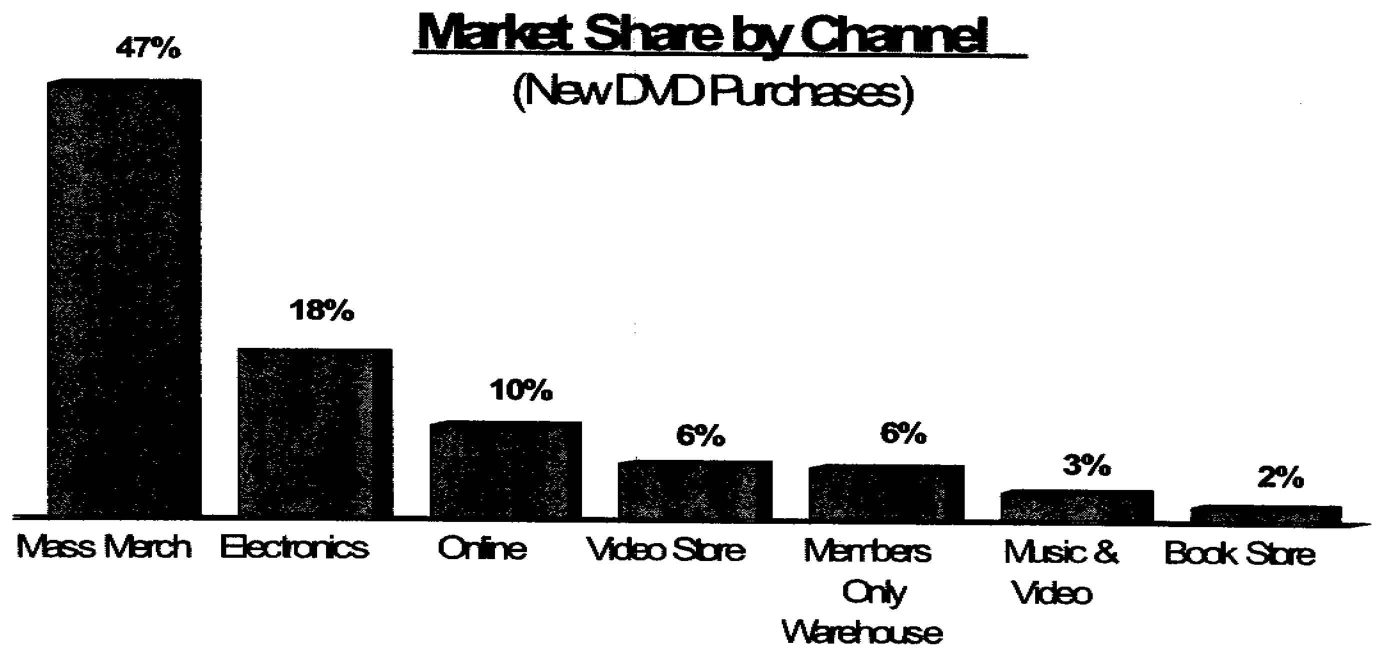
DVD buyers are slightly more male and about 5 ppts less African-American.





The Entertainment Consumer: DVD share

Mass Merchants hold the largest piece of the market, with Electronic Stores as number two, at less than half the share of the market leader.



Average Price:	$14.89	$17.79	$19.30	$18.68	$18.56	$20.29	$20.94

The Entertainment Consumer: Why do they buy DVDs?

In Store & Advertising Motivators - 2004

Browsing is the top retail motivator for DVDs - nearly twice that of CDs. Advertisements and in-store displays are also more effective for DVDs.

Top Five Store/ Advertising Motivators	DVD Sales	CD Sales
Found it while browsing	23.1	11.8
On sale	22.4	N/A
Saw a TV ad	14.0	2.9
Saw special display in store	11.9	4.6
Read a sales circular	5.2	1.9

The Entertainment Consumer: Why do they buy DVDs?

Retail Purchase Influences - 2004

The number one message getting across to consumers in advertising is the collectable nature of DVDs.

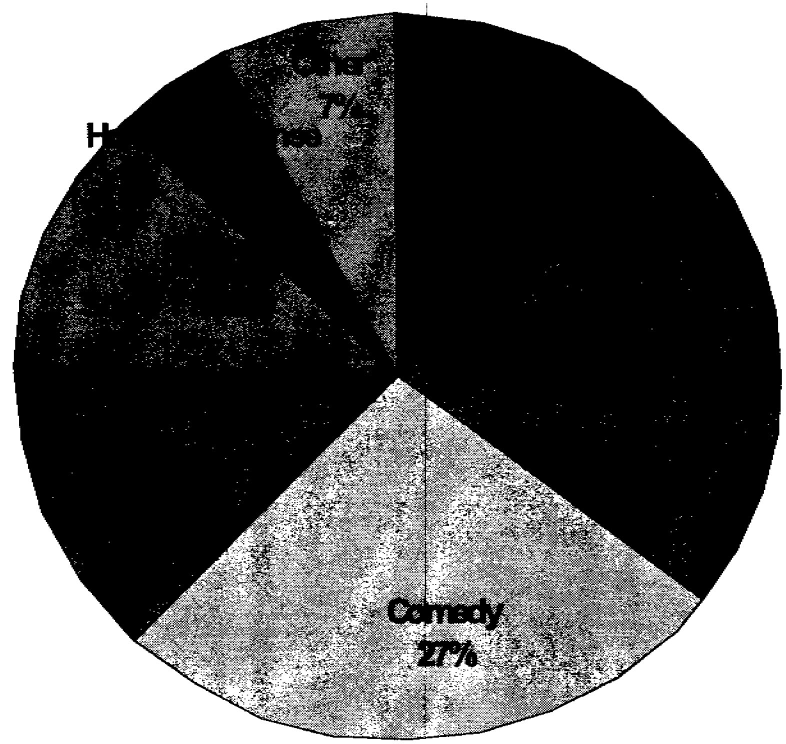
Industry - 2004 Top Ten Purchase Influences	%
Add to my collection	48.8
Fan of these movies/videos	37.3
Like the actors	30.6
Good for the whole family	20.5
Saw a preview or trailer	18.9
For a child/children	16.0
Saw in movie theater	14.6
Saw the movie/show on TV	13.1
Liked previous movie/video	12.5
Recommended by friend/relative	11.0

Source: NPD VideoWatch; Unit Share, New DVD Purchase

The Entertainment Consumer: DVD genre share

Comedy and Drama comprised almost half of Industry sales this year

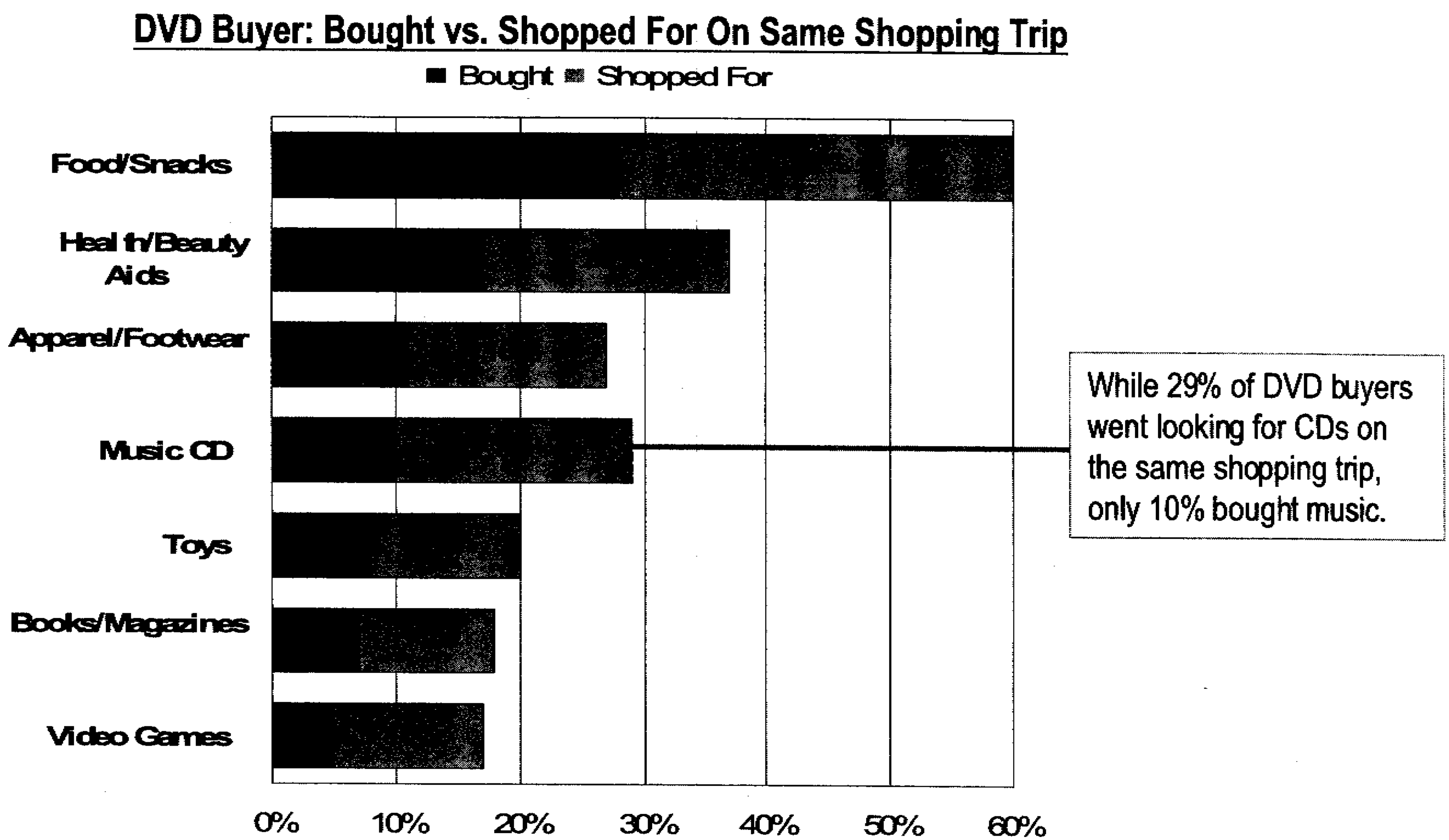
Industry 2004



* Includes:Educational, Foreign Films, Musical, Religious, Sports and Westerns

The Entertainment Consumer: While you were shopping...

Nearly 1/3 of DVD buyers also shopped for music during the same trip. This is a significant conversion opportunity.



Five takeaways

- Tiered pricing may provide some breathing room so that retailers can maintain overall competitive average prices. Consumers will pay less for new/untested artists. Price is less of an issue for premium content and tried-and-true music.

- "The Long Tail" (depth/breadth of selection) is a reality, and it's bringing teens back as physical music buyers. Retailers should consider how they are addressing this issue in all of their communication with customers.

- Digital music can help with selection/sampling issues that would otherwise impede a sale. Additionally, retailers need to stay on top of tastes/trends in the digital music world, as it accounts for half of all music acquired.

- Take a page out of the DVD marketing book. There are many similarities between the demographics of the DVD buyer and the CD buyer, though the marketing tactics differ. Leverage the CD buyer's propensity to purchase premium content and favorite artists with DVD's active "must have" collection-based marketing.

- Cross promotion is key. Retailers could be doing more to cross-promote music with other entertainment categories. The opportunity is there.

Appendix:
Sources, Methodology and Retail Channel Definitions

NPD Music: Primary Sources of Information

- NPD MusicWatch: weekly tracking of music purchases from a panel of consumers
  - **Demographics, shopping habits, retailers, purchase motivators, pricing**
  - **Over 100,000 transactions captured annually**
- MusicWatch Digital: ongoing tracking via a metered sample
  - **Acquisition and use of digital music files & music applications; 10,000 participating households**
- MusicLab: bimonthly tracking of key music & entertainment topics
  - **Attitudes, desirable features; 5,000 respondents each wave.**
- Digital Music Study: annual survey of digital music usage and physical purchasing behavior
  - **Bought more/less/same, legal and illegal digital music usage; 6,000 respondents.**

NPD Music: Methodology

MusicWatch, MusicLab, and Digital Music Study all sourced from NPD Panel - pool of 600,000+ individuals in the U.S.

- Sample projected to 13+ U.S. population - Digital Music Study projected to 13+ U.S. Online population
- Total U.S. geographic representation
- All retailer coverage

MusicWatch Digital is a static panel that volunteers to let NPD directly monitor activity on their home computers.

- 10,000 households
- Actual behavior recorded and reported, rather than self-reported via online survey.

NPD Music: Retail Channel Definitions

Retail Channels - cover physical product only (no digital downloads)

- Online: all websites that sell physical product (amazon.com, borders.com, walmart.com, towerrecords.com, etc.)
- Book Store: independent and chain bookstores
- CD/Record Store: independent and chain CD/Record Stores
- Discount/Mass Merchants: independent and chain discount/mass merchant stores
- Members Only Warehouse: wholesale outlets that require membership (CostCo, Sam's, etc.)
- Electronics: independent and chain electronics stores
- Other: non-traditional music retail outlets (department stores, coffee shops, convenience stores, etc.)

NPD Music

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